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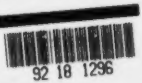
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549



FORM 10-Q

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922277

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended May 31, 1992

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from _____ to _____

Commission file number: 0-18268

INTEGRATED SYSTEMS, INC.

(Exact name of Registrant as specified in its charter)

California	**94-2658153**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

3260 Jay Street
Santa Clara, California 95054-3309
(408) 980-1500
(Address, including zip code, of Registrant's principal executive offices and telephone number, including area code)

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Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes __X__ No ____

The number of shares outstanding of the Registrant's Common Stock on June 30, 1992 was 9,266,993 shares.

The Exhibit Index is located on page 12.

INTEGRATED SYSTEMS, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

The condensed consolidated interim financial statements included herein have been prepared by Integrated Systems, Inc. (the "Company"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures made are adequate to make the information presented not misleading. It is suggested that the condensed consolidated interim financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended February 28, 1992.

The accompanying condensed consolidated interim financial statements have been prepared in all material respects in conformity with the standards of accounting measurements set forth in Accounting Principles Board Opinion No. 28 and, in the opinion of management, reflect all adjustments, consisting only of normal recurring adjustments, necessary to summarize fairly the financial position and results of operations for such periods. The results of operations for such interim periods are not necessarily indicative of the results to be expected for the full year.

The Company adopted Statement of Position 91-1, Software Revenue Recognition ("SOP") in the first quarter of fiscal 1993. This adoption requires the deferral and ratable recognition over the service period of software maintenance revenue bundled with initial product license revenue and renewal revenue related to product license renewals where the renewal amount is substantially less than the initial license fee. In prior periods such revenue was recognized upon shipment of the product license or execution of the renewal. The Statement requires the restatement of previously reported financial information and the results for prior years and prior quarters have been restated accordingly.

The Company's fiscal year is reported on a 52/53-week period ending on the last Saturday in February of each year. Quarterly periods do not necessarily end on the last day of a calendar month. For clarity of presentation herein, all fiscal periods, including quarters, are treated as ending on a calendar month-end.

INTEGRATED SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS
(in thousands)

	February 28, 1992 (restated) (1)	May 31, 1992 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$6,641	$7,467
Marketable securities	17,344	19,535
Accounts receivable, net	7,792	6,477
Deferred income taxes	821	1,104
Other current assets	635	673
Total current assets	33,233	35,256
Property and equipment, net	2,092	2,005
Other assets	243	310
Intangible assets, net	2,849	2,745
Total assets	$38,417	$40,316
LIABILITIES		
Current liabilities:		
Accounts payable	$540	$270
Accrued payroll and related expenses	1,261	1,022
Other accrued liabilities	884	736
Income taxes payable	1,017	1,852
Deferred revenue	3,485	4,049
Deferred income taxes	—	—
Total current liabilities	7,187	7,929
Other liabilities	284	307
Total liabilities	7,471	8,236
SHAREHOLDERS' EQUITY		
Common Stock, no par value, 25,000 shares authorized: 9,239 and 9,263 shares issued and outstanding at February 28, 1992 and May 31, 1992, respectively	30,627	30,826
Retained earnings	319	1,254
Total shareholders' equity	30,946	32,080
Total liabilities and shareholders' equity	$38,417	$40,316

(1) Restated in accordance with Statement of Position 91-1, Software Revenue Recognition

The accompanying notes are an integral part of these consolidated financial statements.

INTEGRATED SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)
(unaudited)

	Three Months Ended May 31,	
	1991 (restated) (1)	1992
Revenue:		
Product licenses	$3,206	$5,924
Engineering services	1,281	1,321
Total revenue	4,487	7,245
Costs and expenses:		
Cost of revenue	1,104	1,458
Marketing and sales	1,450	2,354
Research and development	903	1,450
General and administrative	483	585
Amortization of intangible assets	—	308
Total costs and expenses	3,940	6,155
Income from operations	547	1,090
Interest and other income	549	349
Income before income taxes	1,096	1,439
Provision for income taxes	384	504
Net income	$712	$935
Earnings per share	$0.08	$0.10
Shares used in per share calculations	8,400	9,518

(1) Restated in accordance with Statement of Position 91-1, Software Revenue Recognition.

The accompanying notes are an integral part of these consolidated financial statements.

INTEGRATED SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(unaudited)

	Three Months Ended May 31,	
	1991	1992
	(restated) (1)	
Cash flows from operating activities:		
Net income	$712	$935
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation and amortization	156	454
Deferred income taxes	25	(283)
Changes in assets and liabilities:		
Accounts receivable	28	1,315
Other current assets	(108)	(38)
Accounts payable, accrued payroll and other accrued liabilities	(69)	(657)
Income taxes payable	(95)	835
Deferred revenue	(85)	564
Other assets and liabilities	59	(44)
Net cash provided by operating activities	623	3,081
Cash flows used in investing activities:		
Purchases of marketable securities, net	(3,764)	(2,191)
Additions to property and equipment, net	(370)	(223)
Net cash used in investing activities	(4,134)	(2,414)
Cash flows from financing activities:		
Proceeds from exercise of common stock options and purchases under the employee stock purchase plan	115	159
Net cash provided by financing activities	115	159
Net increase (decrease) in cash and cash equivalents	(3,396)	826
Cash and cash equivalents at beginning of period	4,071	6,641
Cash and cash equivalents at end of period	$675	$7,467
Supplemental disclosure of cash flow information:		
Net cash paid (received) during the period for income taxes	$407	($47)

(1) Restated in accordance with Statement of Position 91-1, Software Revenue Recognition.

The accompanying notes are an integral part of these consolidated financial statements.

INTEGRATED SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Information for the three months ended
May 31, 1991 and 1992 is unaudited)

1. Summary of Significant Accounting Policies

The condensed consolidated financial statements include the accounts of Integrated Systems, Inc. and its wholly owned subsidiaries, after elimination of all significant intercompany accounts and transactions, and should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended February 28, 1992. The February 28, 1992 balance sheet data, after restatement for Statement of Position 91-1, Software Revenue Recognition (see Note 2), were derived from the audited financial statements. The balance sheet data do not include all disclosures required by generally accepted accounting principles.

2. Adoption of Statement of Position 91-1, Software Revenue Recognition

The Company adopted Statement of Position 91-1, Software Revenue Recognition ("SOP") in the first quarter of fiscal 1993. This adoption requires the deferral and ratable recognition over the service period of software maintenance revenue bundled with initial product license revenue and the deferral and ratable recognition of renewal revenue related to product license renewals where the renewal amount is substantially less than the initial license fee. In prior periods such revenue was recognized upon shipment of the product license or execution of the renewal. Under the SOP, the Company now allocates the portion of its product license revenue related to software maintenance revenue based upon product license renewal amounts which are substantially less than the initial product license fee when such services are not sold separately, or based upon the amount charged for such services when they are sold separately and recognizes such revenue ratably over the service period. Furthermore, license revenue amounts that are substantially less than the initial license are deferred and recognized ratably over the license term. The Statement requires the restatement of previously reported financial information and the results for prior years and prior quarters have been restated accordingly.

The impact of the restatement on total revenue, net income and earnings per share for the three months ended May 31, 1991 and 1992 is as follows:

	Three Months Ended May 31,	
	1991	1992
(in thousands, except per share data)		
Total revenue, before impact of SOP (as reported in fiscal 1992)	$4,419	$7,223
Impact of SOP	68	22
Total revenue, as restated	$4,487	$7,245
Net income, before impact of SOP (as reported in fiscal 1992)	$668	$921
Impact of SOP	44	14
Net income, as restated	$712	$935
Earnings per share, before impact of SOP (as reported in fiscal 1992)	$0.08	$0.10
Impact of SOP	—	—
Earnings per share, as restated	$0.08	$0.10

3. Software Development Costs

The Company incurs certain costs to develop computer software to be licensed or otherwise marketed to customers. In prior periods, costs that would be required to be capitalized under Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS No. 86") have not been significant. As a result of an increased emphasis on quality, longer testing periods and the addition of Software Components Group costs, such capitalizable costs have become more significant; consequently, the Company capitalized $164,000 of research and development expenses related to the development of software products in the first quarter of fiscal 1993 in accordance with the requirements of SFAS No. 86.

4. Earnings Per Share

Earnings per share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period when such equivalents have a dilutive effect. Dilutive common equivalent shares consist of stock options (using the treasury stock method).

The following table sets forth the calculation of earnings per share for purposes of this report:

	Three Months Ended May 31,	
(in thousands, except per share data)	1991	1992
	(unaudited)	
Primary:		
Net income	$712	$935
Number of shares:		
Weighted average number of common shares outstanding	8,148	9,255
Dilutive effect of options, net	252	263
	8,400	9,518
Earnings per share	$0.08	$0.10
Fully diluted:		
Net income	$712	$935
Number of shares:		
Weighted average number of common shares outstanding	8,148	9,255
Dilutive effect of options, net	256	263
	8,404	9,518
Earnings per share	$0.08	$0.10

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following information should be read in conjunction with the consolidated interim financial statements and the notes thereto included in Item 1 of this Quarterly Report and with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Company's Annual Report on Form 10-K for the year ended February 28, 1992, as filed with the Securities and Exchange Commission on May 26, 1992.

Results of Operations

The Company adopted Statement of Position 91-1, Software Revenue Recognition, in the first quarter of fiscal 1993. This adoption requires the deferral and ratable recognition over the service period of software maintenance revenue bundled with initial product license revenue and the deferral and ratable recognition of renewal revenue, related to product license renewals where the renewal amount is substantially less than the initial license fee. In prior periods such revenue was recognized upon shipment of the product license or execution of the renewal. The Statement requires the restatement of previously reported financial information and the results for prior years and prior quarters have been restated accordingly.

The following table sets forth for the periods indicated (a) the percentage of total revenue represented by each line item in the Company's consolidated statements of income and (b) the percentage change in each line item from the prior period:

	Percentage of Total Revenue		Percentage Change
	Three Months Ended May 31,		Three Months Ended May 31,
	1991 (1)	1992	1991 to 1992
Revenue:			
Product licenses	71 %	82 %	85 %
Engineering services	29	18	3
Total revenue	100	100	61
Costs and expenses:			
Cost of revenue	25	20	32
Marketing and sales	32	32	62
Research and development	20	20	61
General and administrative	11	8	21
Amortization of intangible assets	—	5	N/A
Total costs and expenses	88	85	56
Income from operations	12	15	99
Interest and other income	12	5	(36)
Income before income taxes	24	20	31
Provision for income taxes	8	7	31
Net income	16 %	13 %	31 %

(1) Restated percentages in accordance with Statement of Position 91-1, Software Revenue Recognition

Revenue

The Company's revenue is primarily derived from the licensing of its products, related license renewals and engineering services. The Company's total revenue grew 61% from the first quarter of fiscal 1992 to the first quarter of fiscal 1993, primarily as a result of the inclusion of $2,295,000 product license revenue from Software Components Group ("SCG") which was acquired in the second quarter of fiscal 1992. Total revenue, excluding SCG revenue, increased by 10% between these comparison periods. Aggregate product license revenue, excluding SCG revenue, increased by 13% between these comparison periods.

Costs and Expenses

The Company's cost of revenue as a percentage of total revenue decreased from 25% to 20% from the first quarter of fiscal 1992 to the first quarter of fiscal 1993. The decrease is due to the higher margins associated with the products acquired from SCG, which are primarily software, when compared to the Company's engineering services and products that have a hardware component, which have lower margins.

Marketing and sales expenses increased approximately $904,000 in absolute dollars between the quarterly comparison periods but was the same as a percentage of total revenue between the comparable periods. The increase in absolute dollars was primarily the result of the inclusion of the costs of SCG employees for the first quarter of fiscal 1993. Research and development expenses and general and administrative expenses also grew substantially in absolute dollars between the comparison periods, primarily as a result of the inclusion of the costs of SCG employees for the first quarter of fiscal 1993. In addition each of these expense categories increased because of growth in headcount and associated expenses in the Company's pre-acquisition business.

Costs and expenses in the first quarter of fiscal 1993 include $308,000 of on-going amortization of intangible assets (purchased software, goodwill and a covenant not to compete) in connection with the acquisition of SCG, which was acquired in the second quarter of fiscal 1992.

In prior periods, costs that would be required to be capitalized under Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS No. 86") have not been significant. As a result of an increased emphasis on quality, longer testing periods and the addition of SCG costs, such capitalizable costs have become more significant; consequently, the Company capitalized approximately $164,000 of research and development expenses related to the development of software products in the first quarter of fiscal 1993 in accordance with the requirements of SFAS No. 86. The amount capitalized represents approximately 10% of total research and development costs for the first quarter of fiscal 1993. The amount of research and development expenditures capitalized in a given time period depends upon the nature of the development performed and, accordingly, amounts capitalized may vary from period to period.

Other

The Company's interest and other income fell from $549,000 to $349,000 between the quarterly comparison periods. The results in the three months ended May 31, 1991 include a gain of $156,000 realized upon the conversion of securities, primarily Treasury Notes, into Federal tax free investments. The remainder is due to a decrease in the average rate of return despite an increase in cash equivalent and marketable securities balances.

Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (SFAS No. 109), was issued in February 1992 and is effective for fiscal years beginning after December 15, 1992. Management has not determined if it will adopt SFAS No. 109 prior to its effective date or which method of adoption will be used to reflect the change in accounting principle. Management has not estimated the impact of adopting SFAS No. 109.

Liquidity and Capital Resources

The Company has funded its operations to date principally through cash flow from operations. As of May 31, 1992, the Company had approximately $27,000,000 of cash, cash equivalents and marketable securities, consisting of the proceeds of the initial public offering, excess cash flow from operations, and cash from the SCG Merger. This represents an increase of approximately $3,000,000 from February 28, 1992. The Company currently has a $1,000,000 unsecured bank line of credit, expiring July 15, 1992, under which borrowings would bear interest at the bank's prime rate. Although the Company has no current need for this line of credit, it presently plans to extend this line. The Company has never borrowed under this line and has no long-term debt. The Company believes that cash flow from operations, together with existing cash balances and available borrowings, will be adequate to meet the Company's cash requirements for the foreseeable future.

Net cash provided by operating activities during the first quarter of fiscal 1993 totaled $3,081,000 compared to $623,000 in the first quarter of fiscal 1992. The increase in cash from operating activities was primarily due to increased net income before depreciation and amortization and a decrease in accounts receivable. Net cash used in investing activities totaled $2,414,000 in the first quarter of fiscal 1993 compared to $4,134,000 in the first quarter of fiscal 1992 as the Company reduced its net purchases of marketable securities by $1,573,000. The Company expects that it will be able to sustain its level of expenditures on property and equipment, as it has in the past, from cash flow from operations.

PART II - OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

At the Annual Meeting of Shareholders held July 9, 1992, the shareholders approved an amendment to the Company's 1988 Incentive Stock Option Plan to increase the number of shares reserved for issuance thereunder from 1.0 million shares to 2.0 million shares by a vote of 6,432,025 for, 821,582 against and 18,943 abstain.

Item 5. Other Information

On June 16, 1992, the Company's Form S-8 Registration Statement was filed with the Securities and Exchange Commission covering the registration of an additional 1,000,000 shares of Common Stock issuable under the Company's 1988 Incentive Stock Option Plan.

Item 6. Exhibits and Reports on Form 8-K

(a) **Exhibits.**

Exhibit Number	Title	Page Number
22.01	List of Registrant's Subsidiaries	14

(b) **Reports on Form 8-K.** No reports on Form 8-K were filed by Registrant during the three months ended May 31, 1992.

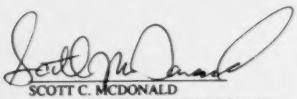
SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: July 10, 1992

INTEGRATED SYSTEMS, INC.
(Registrant)

NARENDRA K. GUPTA
President, Chief Executive Officer
and Secretary
(Duly Authorized Officer)



SCOTT C. MCDONALD
Vice President, Finance and Administration
Chief Financial Officer

EXHIBIT 22.01

SUBSIDIARIES

OF

INTEGRATED SYSTEMS, INC.

1. Integrated Systems, Inc., F.S.C.

   Formed June 3, 1988 - U.S. Virgin Islands

2. Integrated Systems Inc. Limited

   Formed August 24, 1989 - United Kingdom

3. Integrated Systems Inc. SA

   Formed June 1, 1992 - France